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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 1410

MIDWESTERN GAS TRANSMISSION COMPANY, EAST TENNESSEE NATURAL GAS COMPANY, *Petitioners,*

v.

FEDERAL POWER COMMISSION, ET AL., *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Midwestern Gas Transmission Company and East Tennessee Natural Gas Company, Petitioners herein, respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in the above-entitled case on January 5, 1968.

OPINIONS BELOW

The opinion of the Court of Appeals for the Seventh Circuit (App. pp. 79a-87a) is reported at 388 F.2d 444. The opinions and orders of the Federal Power Commission (App. 1a-69a, 69a-78a) are reported at 36 F.P.C. 61 and 36 F.P.C. 599 (1966).

JURISDICTION

The judgment of the Court of Appeals was entered January 5, 1968 (App. 88a). The joint petition for rehearing of Midwestern and East Tennessee was denied on February 7, 1968 (App. 89a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19 of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Where the management of a natural gas pipeline company elects to use straight-line tax depreciation as authorized by Section 167 of the Internal Revenue Code in order to avoid the serious long-term financial risks and uncertainties to which, in management's considered judgment, the company would be subject if it used "liberalized" tax depreciation, may the Federal Power Commission disallow a portion of the company's resulting tax expense by reducing its rates subject to regulation under the Natural Gas Act as if the company had used "liberalized" tax depreciation?

STATUTES INVOLVED

The pertinent provisions of Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a) and of Section 167 of the Internal Revenue Code, 26 U.S.C. 167, are set out in the Appendix, *infra*, pp. 90a-91a.

STATEMENT

Petitioners, Midwestern Gas Transmission Company (Midwestern) and East Tennessee Natural Gas Company (East Tennessee), are natural gas companies whose rates for the sale of natural gas for resale in interstate commerce are subject to regulation by the Federal Power Commission (Commission) as provided in the Natural Gas Act.

Midwestern is a Delaware corporation which owns and operates two non-connected pipeline systems—a southern system and a northern system. The southern system extends from Portland, Tennessee, where Midwestern takes delivery of natural gas from its supplier, to a point near Joliet, Illinois, where it delivers gas to three distribution companies in the Chicago-Gary area. The northern system extends from a connection with Midwestern's Canadian gas supplier at the International Boundary near Emerson, Manitoba, to a point near Marshfield, Wisconsin, where it connects with the pipeline of its major customer in that area (R. 28-29).[1]

East Tennessee, a Tennessee corporation, owns and operates a relatively small pipeline system which originates in Tennessee, where it purchases its natural gas supplies at points near Lobelville and Greenbrier, Tennessee, and extends eastward through Tennessee and then northward to its terminus near Roanoke, Virginia. East Tennessee uses its pipeline system to transport and sell natural gas to communities and industries in middle and east Tennessee and southwestern Virginia.

In separate investigations instituted under Section 5(a) of the Natural Gas Act into the reasonableness of

[1] "R" refers to the joint appendix which was printed in the court below and which has been filed with the Clerk of this Court as part of the certified record.

the rates of Midwestern and East Tennessee (R. 323-332), the Commission severed out and reserved for separate decision the rate treatment to be accorded the election by each company to use straight-line depreciation for federal income tax purposes on plant subject to that option under Section 167 of the Internal Revenue Code (R. 400-401). Following the close of the records in these separate proceedings, the Commission consolidated the proceedings for oral argument and decision (R. 390-392, 400). In the opinion issued on July 15, 1966 (App. 1a-51a), the Commission held, over the vigorous dissent by two Commissioners (App. 52a-69a), that despite the election by each company to use straight-line tax depreciation, the amount allowed for federal income taxes in fixing their rates should be computed as if in fact they were using "liberalized" depreciation. Accordingly, the Commission ordered a reduction in the companies' rates, effective January 1, 1967, to reflect the resulting currently lower federal income taxes (App. 45a-51a). Following the denial of rehearing (App. 69a-78a), Midwestern and East Tennessee sought judicial review,[2] and the court below affirmed (App. 79a-87a).

Straight-Line v. "Liberalized" Tax Depreciation

Rates fixed under the Natural Gas Act are required to be designed to permit recovery of the company's cost of service, including an allowance for federal income tax expense (R. 416).[3] One of the major factors involved in determining such expense is the tax deduc-

[2] Although East Tennessee's petition for review initially was filed with the Sixth Circuit, it was transferred to the Seventh Circuit under 28 U.S.C. 2112(a) inasmuch as Midwestern's petition was filed earlier in the latter court.

[3] *F.P.C.* v. *United Gas Pipe Line Co.*, 386 U.S. 237, 238 (1967).

tion for depreciation, i.e., the allowance for exhaustion, wear and tear, and obsolescence of the property, and one of the common methods of determining that tax deduction is the straight-line method under which depreciation is computed each year on a uniform basis throughout the useful life of the property.[4] This method was used by virtually all businesses prior to 1954—and, by many businesses thereafter—in determining both their tax and book depreciation.[5] Also, it has been, and is, used by the Commission in determining the book (as distinguished from tax) depreciation to be included in the cost of service of pipeline companies subject to its jurisdiction.

In 1954 Congress enacted Section 167 of the Internal Revenue Code (App. 91a), authorizing taxpayers to determine tax depreciation for new plant constructed in that year or thereafter, by the use of either (1) straight-line depreciation or (2) one of several so-called "liberalized" depreciation methods there set out.[6] The latter methods result in larger tax depreciation deductions, and hence lower taxes, during the early life of the property. This, in turn, is offset by smaller tax depreciation deductions, and hence higher taxes, in the later years. However, since the tax depreciation which may be taken with respect to any property is limited to 100% of its cost (less salvage), the total tax depreciation available over the life of the particular

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[4] For example, an asset having a 25-year life would be depreciated under the straight-line method at an annual rate of 4% of its cost for 25 years.

[5] "Book depreciation" means the depreciation expense which the company records on its books as the depreciation actually experienced by it.

[6] Such election was to be made on property additions in each year, independent of the election made as to property additions in prior years.

asset is the same regardless of the method of depreciation used; the method selected affects primarily the times at which the various portions of the total tax depreciation are taken (R. 39-40). See *Cities of Lexington* v. *F.P.C.*, 295 F.2d 109, 111-112 (4th Cir. 1961).

Administrative Background

Shortly after the enactment of Section 167 of the Internal Revenue Code in 1954, the Commission in *Amere Gas Utilities*, 15 F.P.C. 760, (1956), adopted what has become known as the normalization principle with regard to tax depreciation. Under this principle, companies using liberalized depreciation were treated for rate purposes as if they were taking straight-line depreciation; however, to the extent that the resulting tax allowance exceeded the tax actually payable under liberalized depreciation (as would be the case in the early years), the excess was held in a special reserve to provide the funds which the company would need to offset its increased tax obligations in the later years when the liberalized depreciation allowance would be less than that under straight-line depreciation. In the period through 1964, the Commission, in case after case upheld on judicial review, consistently applied this principle.[7]

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[7] *El Paso Natural Gas Co.*, 22 F.P.C. 260, 265-67 (1959), remanded on other grounds, *El Paso Natural Gas Co.* v. *F.P.C.*, 281 F.2d 567 (5th Cir. 1960), *cert.* denied, 360 U.S. 912 (1961); *United Fuel Gas Co.*, 23 F.P.C. 127, 130-31 (1960), remanded on other grounds, *Cities of Lexington* v. *F.P.C.*, 295 F.2d 109 (4th Cir. 1961); *Phillips Petroleum Co.*, 24 F.P.C. 537, 570 (1960), aff'd, *Wisconsin* v. *F.P.C.*, 303 F.2d 380 (D. C. Cir. 1961), aff'd, 373 U.S. 294 (1963); *Northern Natural Gas Co.*, 25 F.P.C. 431 (1961); *Kansas-Nebraska Natural Gas Co.*, 25 F.P.C. 448, 451-52 (1961); *Panhandle Eastern Pipe Line Co.*, 25 F.P.C. 550 (1961), aff'd, *Panhandle Eastern Pipe Line Co.* v. *F.P.C.*, 316 F.2d 659 (D. C. Cir. 1963), *cert.* denied, 375 U.S. 881 (1963).

As a result many pipelines, including East Tennessee and Midwestern, elected to use liberalized depreciation in computing their taxes.

However, in its opinion issued in February 1964, in *Alabama-Tennessee Natural Gas Co.*, 31 F.P.C. 208 (1964), aff'd, 359 F.2d 318 (5th Cir. 1966) *cert.* denied, 385 U.S. 847 (1966), the Commission completely reversed its treatment of companies using liberalized tax depreciation. The Commission there ruled that henceforth such companies would be required to "flow through" the full amount of the tax effect of the deduction resulting from the use of liberalized depreciation. Thus, under the Commission's new ruling, the companies would no longer be permitted to accumulate a reserve with which to meet the higher taxes down-the-road stemming from the use of liberalized depreciation.

Facts Relating to Midwestern

In its income tax returns for the years 1959 (its first year of operations) to 1962, Midwestern had elected to use liberalized depreciation for virtually all its depreciable assets (R. 41, 407-408). However, upon reconsideration of its depreciation policy in light of the Commission's decision in *Alabama-Tennessee,* Midwestern's management concluded that *Alabama-Tennessee* had so drastically changed conditions that continuing the use of liberalized depreciation would subject the company to unwarranted and serious uncertainties and risks to its long-term financial integrity.

While *Alabama-Tennessee's* requirement of "flow through" would result in currently lower costs and thus make possible temporary rate reductions for the immediate present, it would also have the effect of inflating tax costs for the future. Midwestern's growth

prospects were limited by the significantly lower rates of competing pipelines and by vigorous competition from alternate fuels, particularly coal; accordingly, its management was concerned whether Midwestern would have the long-term future plant growth necessary to offset the increases in income taxes which otherwise would result as its present properties grew older (R. 29-35, 61-63). In addition, the management felt that continued use of liberalized depreciation with its flow through requirements would place Midwestern in the position of having to have an immediate rate increase of about $1,000,000 and subsequent rate increases of approximately $270,000 annually with concomitant rate instability, risks and uncertainties (R. 54, 61-63, 106-107) and would impair Midwestern's ability to meet the interest coverages required by its bond indenture (R. 63, 65-68). Accordingly, to avoid the threatened financial risks and uncertainties which would result from the continued use of liberalized depreciation, Midwestern's Board of Directors decided that henceforth the company should use straight-line tax depreciation (R. 60-66, 291).[8]

Facts Relating to East Tennessee

While East Tennessee had also been using liberalized depreciation prior to the Commission's decision in *Alabama-Tennessee* (R. 409), East Tennessee's management similarly reconsidered its tax depreciation policy with the issuance of that decision. In 1964, the company had undertaken the largest plant addition in

[8] Section 167(e) of the Internal Revenue Code permits a taxpayer to change from liberalized to straight-line depreciation without obtaining the prior consent of the Internal Revenue Service.

its history. This was in contrast to the relatively small plant additions prior thereto on which it had taken liberalized depreciation. (R. 9, 359, 396, 490-491). In these circumstances, East Tennessee's management was fearful that should the company continue to use liberalized depreciation with the Commission's new requirement of flow through, it would not have the requisite reserve with which to meet the future increased tax liabilities with respect to a substantial portion of its plant (R. 491). In addition, the company was at that time threatened with the loss of all foreseeable future growth of its largest market as well as a substantial portion of its existing sales in that market (R. 3, 485-486, 491-492). Concerned over whether it would have the plant growth with the higher liberalized depreciation deductions in the early years necessary to counteract the decreased deductions on its existing plant, East Tennessee's management concluded that its soundest course was to discontinue liberalized depreciation and henceforth to use straight-line depreciation for tax purposes (R. 2, 9-10, 14).

The Commission's Opinions

Brushing aside the above decisions of Midwstern's and East Tennessee's managements, the Commission undertook to make a new and independent determination with regard to the companies' future growth prospects (App. 14a-36a). Stressing its finding in *Alabama-Tennessee* that liberalized depreciation results in a tax savings (App. 6a-9a), the Commission purported to analyze the pertinent materials, from which it forecast that Midwestern's and East Tennessee's future growth would be such that the liberalized depreciation tax deductions would always exceed those under

straight-line depreciation (App. 30a-36a). Based on this theory of continuous "borrowing" under which the deferred tax liability resulting from the decreasing liberalized depreciation deductions on current plant can be avoided by "borrowing" the initially high depreciation deductions on future plant additions, the Commission prognosticated that the companies would not be confronted with the risks and uncertainties which they feared would result from the use of liberalized depreciation with "flow through". Accordingly, it ordered the companies to reduce their rates to reflect the full amount of the lower income tax which would result currently if the companies were using liberalized depreciation (App. 36a-39a, 45a-51a).

On appeal, the Court of Appeals affirmed (App. 79a-87a).

REASONS FOR GRANTING THE WRIT

The question presented by this proceeding is plainly one of far-reaching and continuing importance. Its resolution affects not only the several companies subject to Commission regulation which have already elected to use straight-line, rather than liberalized tax depreciation, but also potentially virtually every natural gas pipeline company and electric utility subject to Commission regulation. If not reversed, the decision below effectively deprives these companies, as the Commission admits (App. 14a), of the option provided in Section 167 of the Internal Revenue Code, to use straight-line depreciation in preference to liberalized depreciation in the computation of their federal income taxes.

Moreover, the decision below subjects these companies to the risk of serious impairment of their financial and economic well-being. As already noted, the result reached by the Commission majority and approved by the court below, is predicated on the assumed accuracy of its speculative forecast as to the long-term growth prospects of the companies subject to its jurisdiction. However, there is no assurance that the facts as they actually develop will coincide with the speculative forecast of the Commission majority or its underlying continuous borrowing theory. Should, therefore, the Commission majority prove to be a poor prophet, many of the companies, which may have been required to take liberalized depreciation by virtue of the ruling below, might well find their futures mortgaged, their markets shrunk due to any of a variety of factors, and hence, their financial integrity impaired by virtue of their inability to recover all their costs, including their higher income tax liabilities, regardless of how high the Commission permits them to raise their rates (see, *e.g.*, 467-470).

Since, as also shown *infra*, the decision of the court below is demonstrably unsound, review by this Court, we submit, is clearly called for.

1. (a) The holding of the Commission majority, approved by the court below, violates the established principle of utility regulation prohibiting the disallowance of an expense incurred by the management of the regulated enterprise in the absence of a convincing showing that such expense was wasteful, dishonest or an abuse of discretion. The holdings to this effect in *Southwestern Bell Telephone Co.* v. *Comm'n*, 262 U.S. 276, 289 (1923), and in *West Ohio Gas Co.* v. *Comm'n*,

294 U.S. 63, 72 (1935) have been followed and applied in a host of cases.[9]

Thus, while the Commission is not barred from reviewing management's business judgment, it may not freely substitute its judgment for that of management simply because, had it been management, it would have acted differently. It is management—not the Commission—which is the most familiar with the company's operations and financial affairs and which has the responsibility for the financial integrity of the company. In these circumstances, the judgment of management as to the method of tax depreciation which is best designed to protect the company's long term economic health should not be set aside unless demonstrated to be imprudent. This is particularly so where, as here, resolution of the problem involved necessitates a forecast as to the future and there are valid and reasonable differences of opinion on what that future may bring. It is all the more so since, contrary to the implication of the court below (App. 85a), the companies' net earnings will not be increased by virtue of their tak-

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[9] See, e.g., *Nevada Pub. Serv. Commission* v. *Ely Light & Power Co.*, 80 Nev. 312, 324, 393 P. 2d 305, 311-12 (1964); *Central Maine Power Co.* v. *Maine Pub. Utilities Comm.*, 150 Me. 257, 273-75, 109 A. 2d 512, 519-20 (1956); *Norfolk* v. *Chesapeake & Potomac Tel. Co.*, 192 Va. 292, 311-14, 64 S.E. 2d 772, 783-85 (1951); *Southern Bell Telephone & Telegraph Co.* v. *Railroad & Public Utilities Commission*, 253 Ala. 1, 23-24, 42 So. 2d 655, 674 (1949); *Southern Bell Tel. & Tel. Co.* v. *Georgia P.S.C.*, 203 Ga. 832, 878, 49 S.E. 2d 38, 66 (1948); *Northern States Power Co.* v. *Board of R.R. Comm'rs.*, 71 N.D. 1, 298 N.W. 423, 433-34 (1941); *Wisconsin Tel. Co.* v. *Public Service Comm.*, 232 Wis. 274, 287 N.W. 122 (1939); *Chambersberg Gas Co.* v. *Public Serv. Comm'n*, 116 Pa. Super. 196, 227, 176 Atl. 794, 806 (1935); *Monroe Gaslight & Fuel Co.* v. *Michigan P.U.C.*, 11 F. 2d 319, 325 (E.D. Mich. 1926).

ing straight-line tax depreciation instead of liberalized depreciation with flow through.

(b) Not only did the court below approve the Commission's substitution of its judgment for that of management based solely on a difference of opinion (App. 85a, 86a), but the court sought to justify such improper action by ruling that "there is no credible support for concluding that the Commission was not reasonably warranted in making its favorable estimates for future plant growth for both petitioners" (App. 85a, see also 86a).

In thus assuming that the issue before it for determination was the adequacy of the record evidence to support the *Commission's forecasts* as to future plant growth and financial impact of the use of liberalized depreciation with flow through, the court manifested a basic misconception as to the issue here presented. Since the controlling legal principle is that expenditures incurred by management may be disallowed only if shown by convincing proof to be wasteful, dishonest or an abuse of discretion, the question for decision was whether the evidence showed that Midwestern's and East Tennessee's managements abused their discretion in deciding to use straight-line tax depreciation in light of the Commission's "about face" on the flow through v. normalization question in *Alabama-Tennessee*.

Hence, contrary to the assumptions underlying the decision of the court below, its responsiblity was not to determine whether the evidence supported the *Commission's disagreement with management's views* as to the future. Rather, its function was to determine whether there is the requisite evidence to demonstrate that *management's decisions* violated the controlling

principles and, accordingly, should be set aside. Any other view as to the judicial function in this regard would make a shambles of the *Southwestern Bell* rule.

(c) Nor can the holding of the court below be justified on the ground that a finding, that the Commission's speculative forecast is supported by adequate evidence, is, *ipso facto,* the equivalent of a finding that the decisions of Midwestern's and East Tennessee's managements exceeded the bounds of permissible discretion. As this Court is well aware, it is commonplace to find situations in which the pertinent materials justify either of two opposing findings so that on an application of the substantial evidence rule, neither finding could be set aside. As a matter of fact, it was on just such a basis that the Fifth Circuit in *Alabama-Tennessee* distinguished the various court decisions affirming the Commission's prior consistent normalization practice with respect to the use of liberalized tax depreciation (see 359 F.2d at 330).

Accordingly, even if it be assumed *arguendo* that the Commission's speculative forecasts here were supported by the requisite evidence as found by the court below (see App. 85a, 86a, 87a),[10] it would not put an end to the matter. Apart from the patent incongruity of treating the exercise of an option specifically

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[10] Should the matter become relevant in connection with the Court's consideration on the merits, it can readily be shown that the Commission forecasts do not, in fact, have the requisite support. Significantly, the record is devoid of any evidence with regard to the future growth of East Tennessee. In this connection, East Tennessee reserves the right, should certiorari be granted, to argue that it has been denied due process of law inasmuch as the sole basis of the Commission's findings in this regard are extra record materials as to which East Tennessee was not given an opportunity to cross examine or present rebuttal evidence.

bestowed by Congress as beyond the permissible discretion of management, the available materials demonstrate the reasonableness of the action taken by Midwestern's and East Tennessee's managements on the basis of *their* projections as to the future. Eminent authorities and responsible agencies such as the Securities and Exchange Commission and the American Institute of Certified Public Accountants have stressed the necessity of recognizing the deferred tax liability which results from the use of liberalized tax depreciation in order to avoid distortion of current income.[11]

On a number of occasions prior to its "about face" in *Alabama-Tennessee,* the Commission itself acknowledged that "assumptions of a continued plant growth and a continuously expanding investment in depreciable property * * * are at best largely speculative and conjectural" (See Commission Brief in Opp. in *California* v. *F.P.C.,* No. 599, Oct. T. 1960, pp. 14-15; see also, e.g., *United Fuel Gas Co.,* 23 F.P.C. 127, 131 (1960), *affirmed, sub nom., Cities of Lexington* v. *F.P.C.,* 295 F.2d 109, 113 (4th Cir. 1964). Similarly, shortly after its decision herein, the Commission stressed that in view of the "dynamic" and "revolutionary" developments taking place in alternate fuels, such as nuclear energy, there could well be a decline in the major uses of natural gas "over the next two decades". *Transwestern Pipeline Co.,* 36 F.P.C. 176, 199 (1966). And, again, as recently as its Brief filed with the court below, the Commission still acknowledged (at p. 29), that "it must be candidly conceded that differences of opinion do exist * * *" among experts as to the risks

[11] Accounting Series Release No. 85, SEC, February 29, 1960; Accounting Research Bulletin No. 44 (revised July 7, 1958) Committee on Accounting Procedure, AICPA.

associated with taking liberalized depreciation. See, also, *infra,* pp. 19-20. Indeed, businesses commonly use straight-line depreciation for tax purposes and literally thousands of businesses have not elected to use liberalized depreciation (see U.S. Treasury Dept., IRS Publication No. 16 (7-64), p. 262).

Accordingly, the fact that a Commission majority here favors one forecast on these matters as against an opposing but reasonable forecast does not mean that the actions taken by the managements of Midwestern and East Tennessee on the basis of such opposing forecast exceed the ambit of managerial discretion.

2. (a) The court below compounded its error by improperly treating the disposition of the issue here as controlled by the earlier decisions in *Alabama-Tennessee, supra,* and *Natural.*[12] For in holding that "most of the issues originally raised have been effectively settled by *Alabama-Tennessee* and *Natural*" (App. 84a, see, also 87a) and further that "under the circumstances found present here, the decision of petitioners to abandon the liberalized method of depreciation in favor of the straight-line method furnishes no material variance to distinguish the result here from that reached in" *Alabama-Tennessee* and *Natural* (App. 86a), the court below ignored the critical differences between *Alabama-Tennessee* and *Natural,* on the one hand, and the instant proceedings, on the other hand.

Thus, both in *Alabama-Tennessee* and in *Natural,* the companies were actually taking liberalized depreciaction and, by asking the Commission to normalize the

[12] *Natural Gas Pipeline Co. of America,* 33 F.P.C. 574 (1965), aff'd in part *sub nom, City of Chicago* v. *F.P.C.,* 385 F. 2d 629 (D.C. Cir., 1967), *cert.* denied, — U.S. — (March 4, 1968).

deduction for rate purposes, they were in effect seeking a tax allowance measured by the taxes currently being paid by them *plus* the additional amount they would have been paying under straight-line depreciation. Since the issue there presented related only to the propriety of an allowance of *an amount in excess of the actual taxes payable* and hence did not involve any actual expenditures by the companies, the resolution thereof was a matter within the Commission's discretion; accordingly, the courts had only to pass on the reasonableness of the Commission's action in *disallowing the excess over the actual taxes payable.*

In contrast, Midwestern and East Tennessee had, in the instant case, exercised the option given them by Section 167 to take straight-line depreciation and, in requesting a federal income tax allowance based on that election, were seeking no more than *their actual tax cost* under that method of tax depreciation. Moreover, the effect of a holding that the companies should be treated as if they were taking liberalized depreciation is to *disallow a portion of the actual tax cost* incurred under straight-line depreciation. Since the issue here, therefore, involves the disallowance of a portion of the actual tax expense payable under that method of tax depreciation, the legal standard here is entirely different from that applicable in *Alabama-Tennessee* and *Natural.* As shown earlier herein, such actual expense may not be disallowed except upon a convincing showing that management has been wasteful, dishonest or guilty of an abuse of discretion.

In line with these critical differences, the Commission and the Fifth Circuit in *Alabama-Tennessee* acknowledged that resolution of the "flow through" v. normalization issue with respect to companies using liberalized

depreciation did not serve also to resolve the issue here involved. 31 F.P.C. at 210; 359 F.2d at 340, and fn. 44. And the Commission has implemented this express acknowledgement by its action in two decisions issued shortly after *Alabama-Tennessee. United Gas Pipe Line Co.*, 31 F.P.C. 1180, 1191, 1238 (1964); *Wisconsin Michigan Power Co.*, 31 F.P.C. 1445, 1457-1458 (1964).

Both *United Gas* and *Wisconsin Michigan* involved, as here, the federal income taxes to be allowed in the rates for companies using straight-line—not liberalized—depreciation. The Commission in *Wisconsin-Michigan* expressly noted that that problem was different i.e. "one step further" than that in *Alabama-Tennesee.* See 31 F.P.C. at 1457. In addition, in refusing to take that "step," the unanimous Commission recognized in both cases, in sharp contrast to the majority ruling here, the existence of a discretion in management to choose among the tax depreciation options provided by Congress. Further pointing out that the "officers firmly believe this to be the wisest course in the long range interests of the Company and its customers," the Commission held that it would be improper, in fixing the company's rates, to "in effect deprive the Company of its option under the tax law" to use straight-line tax depreciation. See 31 F.P.C. at 1457-1458; 31 F.P.C. at 1191, 1238.[13]

[13] The attempt of the Commission majority to distinguish these cases on the ground that their "holdings were based on the failure of the proponent of compulsory flow-through to make a persuasive showing that mandatory use of liberalized depreciation methods would result in a net tax savings to those companies" (App. 24a), is demonstrably unsound, as is readily evident even on a casual reading of the Commission's opinions in these cases. Indeed, Commission Staff Counsel conceded before the Commission that there is no sound basis for distinguishing these cases from the instant case (R. 395).

Similarly, many states have recognized that the two situations were so different as to call for different results. There are numerous state cases in which a regulated company changed from liberalized depreciation to straight-line depreciation following the local agency's adoption of flow through for companies using liberalized depreciation. In each of these cases, the holding consistently has been that the company's tax allowance should be computed on the basis of the straight-line method actually being used, not on the hypothetical assumption that the company was using liberalized depreciation.[14]

(b) Likewise, contrary to the suggestion of the court below, the decisions in *Alabama-Tennessee* and *Natural* do not justify the further finding of the court below that (App. 85a):

> "* * * It has now been judicially determined that the use of the projected liberalized depreciation will result in tax savings for a number of years, rather than tax deferrals. * * *"

As shown earlier herein, far from making any such affirmative determination, the courts in these cases merely deferred to the Commission and affirmed the Commission's determination as supported by the requisite evidence. *Alabama-Tennessee, supra,* 359 F.2d at 339; *Natural, supra,* 385 F.2d at 633-634. For example,

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[14] See, e.g. *City of Pittsburgh* v. *Pennsylvania P.U.C.*, 187 Pa. Super., 341, 359-360, 25 PUR 3d 273, 284 (1958); *Pennsylvania PUC* v. *Penn. Power Co.*, 33 PUR 3d 177, 198-199 (Pa. PUC, 1960); *Re Southern California Gas Co.*, 35 PUR 3d 300, 315 (Cal. PUC, 1960); *Re San Diego Gas & Elec. Co.*, 39 PUR 3d 417, 424 (Cal. PUC, 1961); *Re Cumberland & Allegheny Gas Co.*, 28 PUR 3d 93, 99 (W. Va. PSC, 1959); *Re Housatonic Pub. Serv. Co.*, 22 PUR 3d 1, 11 (Conn. PUC, 1958); *Re Piedmont Natural Gas Co.*, 34 PUR 3d 1, 14-15 (N.C. Util. Comm'n., 1960).

in *Alabama-Tennessee,* the Fifth Circuit, pointing out that "* * * the Commission's decision rests on its reading of the future," recognized that, in reaching its result, the Commission had undertaken to make a choice between "competing economic guesses" (359 F.2d at 339). Simultaneously, however, it called attention to the risk that the Commission's forecast might not work out (*Ibid.*):

> "* * * The Commission must, of course, concern itself with the possibility of having misread the future and with the future's taking a turn without benefit of advice from the Commission. All things change * * *."

Since the courts in *Alabama-Tennessee* and *Natural* thus merely deferred to the Commission's choice among "competing economic guesses," such deference does not mean that the decisions of the managements of Midwestern and East Tennessee, based on the reasonable, albeit different view as to the future, are wasteful, dishonest or an abuse of discretion under the *Southwestern Bell* rule, applicable in the instant proceeding. To the contrary, as shown earlier herein, the managements of Midwestern and East Tennessee were amply justified in electing to pay their full taxes on a current basis by utilizing straight-line tax depreciation rather than gambling that, by continuous *ad infinitum* borrowing from the future, the shortages resulting from today's reduced tax payments will never have to be made up.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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